

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 AID-05 EB-07 NSC-05 CIEP-01

TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00 COME-00

FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 LAB-04

SIL-01 DODE-00 PA-01 PRS-01 L-03 H-02 /087 W

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R 211644Z NOV 75

FM AMEMBASSY BONN

TO SECSTATE WASHDC 4567

INFO AMEMBASSY LONDON

AMEMBASSY PARIS

AMEMBASSY ROME

USMISSION EC BRUSSELS

USMISSION OECD PARIS

AMCONSUL BREMEN

AMCONSUL DUSSELDORF

AMCONSUL FRANKFURT

AMCONSUL HAMBURG

AMCONSUL MUNICH

AMCONSUL STUTTGART

USMISSION USBERLIN

CINC EUR VAIHINGEN

CINC USAFE RAMSTEIN

CINC USAREUR HEIDELBERG

C O N F I D E N T I A L SECTION 01 OF 02 BONN 19044

DEPARTMENT PASS TREASURY, FRB AND CEA

E.O. 11652: GDS

TAGS: EFIN, GW

SUBJECT: FRG CONFIDENTIAL VIEW OF MEDIUM-TERM

ECONOMIC GOALS

1. SUMMARY. ACCORDING TO AN ECONOMICS MINISTRY IDEAL-
SCENARIO MODEL FORECASTING 5 YEARS INTO THE FUTURE,
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UNEMPLOYMENT WILL GRADUALLY DROP TO 600,000 BY THE

BEGINNING OF THE NEXT DECADE, AND WILL AVERAGE 3.7 PERCENT BETWEEN 1976 AND 1980. THIS WILL CALL FOR A REAL GNP GROWTH RATE OF 4.4 PERCENT, WHICH IN TURN IS CONTINGENT ON AN AVERAGE ANNUAL INCREASE IN INVESTMENT OF 6 PERCENT -- BOTH PERHAPS OPTIMISTIC ASSUMPTIONS. IN ADDITION TO BUTTRESSING THE ARGUMENT FOR TAX CUTS FOR BUSINESS, THIS MODEL HAS THE ANCILLARY EFFECT OF POINTING OUT THAT UNCOMMONLY HIGH RATES OF UNEMPLOYMENT ARE LIKELY TO PERSIST FOR MANY YEARS IN GERMANY WITH ALL THE ATTENDANT POLICY REPERCUSSIONS.

2. IN CONNECTION WITH THE UPCOMING "CONCERTED ACTION" MEETING THAT BRINGS TOGETHER REPRESENTATIVES OF THE GOVERNMENT, LABOR AND BUSINESS SECTORS SEMIANNUALLY, THE ECONOMICS MINISTRY HAS PREPARED A RATHER ELABORATE PROJECTION OF MEDIUM-TERM ECONOMIC GOALS. THE OFFICIAL WHO PROVIDED THE INFORMATION, DEPUTY ASSISTANT SECRETARY RAABE, TOLD US THAT WE SHOULD UNDERSTAND QUITE CLEARLY THAT WHAT WAS INVOLVED WAS NOT A FORECAST OF WHAT WAS EXPECTED TO HAPPEN, BUT RATHER WHAT COULD HAPPEN IF AN IDEAL SCENARIO WAS FOLLOWED AIMED AT REACHING A GIVEN UNEMPLOYMENT OBJECTIVE. THE GOAL THAT WAS FIXED WAS THAT UNEMPLOYMENT SHOULD BE DOWN TO 600,000 AS AN ANNUAL AVERAGE BY 1980 (THE 1976-80 AVERAGE ANNUAL UNEMPLOYMENT RATE GIVEN WAS 3.7 PERCENT). IN ORDER TO REACH THIS GOAL SEVERAL OTHER OF THE FACTORS IN THE MODEL HE DEVELOPED HAD TO MEET MINIMAL CRITERIA. AS HE EXPLAINED IT, THESE WERE:

(A) DURING THE 5 YEAR PERIOD 1976-1980 ANNUAL REAL GNP GROWTH WOULD HAVE TO AVERAGE 4.4 PERCENT. NOMINAL GROWTH OVER THE SAME PERIOD WAS TARGETED AT 8.8 PERCENT PER ANNUM.

(B) THE COMPONENTS OF THE GNP OVER THE 1976-1980 PERIOD THAT ARE INCORPORATED IN THIS GROWTH MODEL INCLUDE AVERAGE ANNUAL REAL INCREASE IN PRIVATE CONSUMPTION OF ABOUT 4 PERCENT AND OF ABOUT 2 PERCENT FOR PUBLIC CONSUMPTION. THE AVERAGE ANNUAL RATE OF INCREASE IN REAL TERMS FOR GROSS FIXED INVESTMENT WAS SET AT CONFIDENTIAL

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AROUND 6 PERCENT.

(C) THE RATE OF ANTICIPATED INFLATION IN THE MODEL IS AN ANNUAL AVERAGE OF 4 TO 4-1/2 PERCENT OVER THE FIVE-YEAR PERIOD ENCOMPASSED IN THE TARGET PROJECTION.

(D) NOMINAL WAGE INCREASES ARE ASSUMED TO BE 7-1/2 TO 8 PERCENT. THEREFORE, THERE IS FORESEEN AN AVERAGE

REAL WAGE INCREASE OF 3-1/2 TO 4 PERCENT, WHICH HAS ALSO
BEEN THE HISTORICAL AVERAGE OVER THE PAST SEVERAL YEARS.

(E) THE SAVINGS RATIO IS SEEN AS DROPPING TO 14.5
PERCENT BY THE END OF THE PERIOD IN 1980 AS COMPARED TO
THE 17 PERCENT LEVEL IN THE SECOND QUARTER OF 1975.

(F) THE AVERAGE ANNUAL INCREASE IN PRODUCTIVITY
IN THE FIVE YEAR PROJECTION IS 4.2 PERCENT.

(G) THE NATIVE GERMAN LABOR FORCE IS PROJECTED, DUE
TO THE DEMOGRAPHIC STRUCTURE, TO GROW ON A NET BASIS BY
400,000 OVER THE FIVE-YEAR PROJECTED PERIOD GIVEN THE

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FM AMEMBASSY BONN

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INFO AMEMBASSY LONDON

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C O N F I D E N T I A L SECTION 02 OF 02 BONN 19044

LARGE NUMBER OF NEW ENTRANTS INTO THE LABOR MARKET. THE FOREIGN WORKER FORCE IS SET TO REACH 1.5 TO 1.6 MILLION AT THE END OF THE PERIOD IN 1980. THIS IS ABOUT 500,000 BELOW THE CURRENT LEVEL REGISTERED LEGALLY TO BE WORKING IN GERMANY.

3. THE CURRENT CAPACITY UTILIZATION WAS FIXED AS
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CURRENTLY BEING 11 PERCENT BELOW ITS NORMAL LEVEL. DR. RAABE CLARIFIED HOWEVER, THAT THIS TAKES INTO ACCOUNT THE IDLE LABOR SUPPLY (REGISTERED UNEMPLOYED), WHICH HE ASSUMED WAS 1.1 MILLION PLUS 350,000 NON-REGISTERED UNEMPLOYED OR "STILLE RESERVE", AS WELL AS MACHINERY. IT IS THEREFORE NOT DIRECTLY COMPARABLE TO THE 15 PERCENT BELOW-NORMAL CAPACITY UTILIZATION FIGURE REFLECTED BY THE IFO INSTITUTE. FACTORING THIS PLUS ALL OTHER ELEMENTS INTO THE EQUATION, THE ONLY WAY THAT UNEMPLOYMENT CAN BE BROUGHT DOWN TO THE GOAL LEVEL OF 600,000 BY 1980 IS FOR INVESTMENT TO MAINTAIN A RELATIVELY HIGH RATE OF REAL GROWTH OF 6 PERCENT OVER THE NEXT FIVE YEARS. BY WAY OF CONTRAST, IT HAS DECLINED ON THE AVERAGE OF 3 PERCENT OVER THE PERIOD 1971-1975 (ON THE OTHER HAND, IT INCREASED BY AN ANNUAL AVERAGE OF 4.8 PERCENT BETWEEN 1966 AND 1970). THE WHOLE MODEL CONSTRUCTION IS CENTERED ON THIS BASIC FACT: IN THE ABSENCE OF GREATLY INCREASED INVESTMENT, GERMANY'S FUTURE ECONOMIC GROWTH WILL BE INHIBITED WITH CONSEQUENTLY HIGH LEVELS OF UNEMPLOYMENT BEING UNAVOIDABLE WELL INTO THE MEDIUM-TERM FUTURE. RAABE SAID HE DID NOT FORECAST WHAT THE POLICY MAKERS MUST DO TO BRING ABOUT THE NECESSARY SUBSTANTIAL RESURGENCE IN INVESTMENT. IT IS, HOWEVER, A MAJOR POINT OF HIS BOSS, ECONOMICS MINISTER AND FDP ADHERENT FRIDERICH, THAT INVESTMENT MUST BE SPURRED BY TAX CUTS FOR BUSINESS AND THE ELABORATE MODEL NEATLY BUTTRESSES HIS ARGUMENT. THIS IS NOT A VIEWPOINT COMPLETELY SHARED BY FINANCE MINISTER APEL WHO, BURDENED BY A PROJECTED DM 40 BILLION DEFICIT IN 1976, IS CONCERNED BY, AMONG OTHER THINGS, THE REVENUE LOSSES SUCH A MEASURE WOULD SIGNIFY. HE IS CLEARLY AGAINST STIMULATION OF INVESTMENT BY TAX MEASURES IF UNDERTAKEN IN THE NEAR TERM FUTURE. ON THIS

POLICY ISSUE THE FDP AND SPD SEEM STILL AT LOGGERHEADS. IT IS NOT THAT CLEAR WHAT APEL'S POSITION IS ON THE LONGER TERM POSSIBILITIES OF INVESTMENT INCENTIVES. FURTHERMORE, FINANCE MINISTRY STATE SECRETARY POEHL, AND OTHERS, FEEL THAT PRIVATE CONSUMPTION GROWTH MUST PROVIDE THE INITIAL STIMULUS FOR THE NASCENT RECOVERY. IT IS MAINTAINED, WITH JUSTIFICATION, THAT THE CURRENT EXTREMELY LOW CAPACITY UTILIZATION LEVEL (THE LOWEST IN

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TWENTY YEARS) WOULD FOR SOME TIME NOT BE CONDUCTIVE TO INCREASED INVESTMENT ACTIVITY, NO MATTER HOW MANY SWEETENERS MIGHT BE ADDED TO THE MIX BY GOVERNMENTAL MEASURES.

4. REGARDLESS OF THE MOTIVATIONS FOR THE PROJECTION, IT DOES POINT UP THE FACT THAT RELATIVELY HIGH UNEMPLOYMENT LEVELS ARE VIRTUALLY CERTAIN TO REMAIN IN GERMANY INTO THE NEXT DECADE, EVEN ASSUMING A MOST GENEROUS GNP GROWTH RATE. SINCE THE FAVORABLE CONDITIONS AND STRUCTURES OF THE 1960'S, WHEN A SIMILARLY HIGH GROWTH RATE WAS MAINTAINED AND WHEN UNEMPLOYMENT AVERAGED BELOW 1 PERCENT, NO LONGER EXIST, THE ACHIEVEMENT OF THE TARGETED GROWTH RATE SEEMS MORE OPTIMISTIC THAN NOT. AND IF THE ASSUMED GROWTH RATE OF 4.4 PERCENT IS NOT ACHIEVED, EVEN HIGHER UNEMPLOYMENT MUST BE CONSIDERED THE PROBABLE FUTURE PICTURE. WHAT THIS IMPLIES FOR THE GOVERNMENT'S POLICY OF FULL EMPLOYMENT AND THE MAINTENANCE OF A COSTLY UNEMPLOYMENT INSURANCE SYSTEM IS MOST UNCERTAIN.

5. WHEN ASKED WHETHER HE PLANNED TO GIVE THE SUBJECT STUDY TO DR. GIER SCH, THE GERMAN MEMBER OF THE OECD LONG TERM STUDY GROUP HEADED BY PAUL MCCRACKEN, DR. RAABE SAID NO. HE COMPLAINED THAT THERE WAS LITTLE TO BE GAINED IN GIVING AWAY SUCH DATA, SINCE NOTHING OF SIMILAR VALUE WAS EVER RECEIVED IN RETURN FROM OTHER COUNTRIES -- ESPECIALLY THE U.S. ACTION REQUESTED: IF SOME U.S. MEDIUM-TERM PROJECTIONS ARE AVAILABLE, PERHAPS FROM THE CEA, THAT WE COULD PASS ALONG TO DR. RAABE, WE WOULD BE APPRECIATIVE. HE HAS BEEN EXTRA-ORDINARILY HELPFUL AND INFORMATIVE ON SEVERAL OCCASIONS AND IT WOULD BE USEFUL TO US IF IT IS POSSIBLE FOR US TO BE ABLE TO RESPOND IN THIS WAY.

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